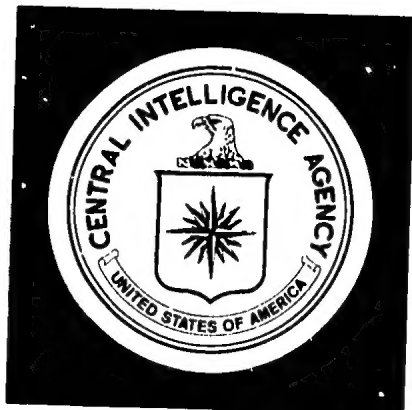


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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Outlook for Thailand's Balance of Payments

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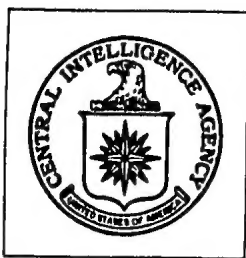
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March 1973

The Outlook for Thailand's Balance of Payments

Thailand's international payments – an important bellwether of economic policies and plans in the past – show prospects of renewed deterioration in 1973. Because the Thais have classically been very sensitive to changes in international reserves in formulating growth and stabilization programs, this development could have major consequences for economic events in that strategically important country.

After nearly a decade of rapid economic growth accompanied by balance-of-payments surpluses, the payments position shifted into deficit in 1969-71 and reserves dropped close to US \$172 million. This trend resulted from such factors as a disappointing merchandise export performance and reductions in the US presence in Thailand with increasing Vietnamization of the war. As reserves declined, Bangkok cut back on some of its development programs, and the result was a decline in economic growth after 1969 from 9% to near 6%. In 1972, exceptionally strong export demand returned, causing the international payments trend to reverse, and exchange reserves rose \$200 million.

The payments prospect for 1973, however, is for a return to an overall deficit, for – despite continued strong world demand – rice and corn shipments will fall from record levels because of poor weather conditions this past summer. The lack of export growth will be accompanied by slight reductions in invisible earnings and capital inflows. Imports, on the other hand, are expected to grow 10%-15% because of increased import prices resulting from recent currency realignments and continued expansion of industrial production. With these projected patterns of foreign exchange earnings and imports, reserves probably will not increase and, indeed, could drop as much as \$150 million.

A decline in reserves, which are still large, need not by itself be particularly disturbing, but the Thais will also take a hard look at the longer term economic prospects, which are not favorable. Faced with a further deterioration in the balance of payments as US military expenditures and aid decline, the government is likely to impose import restrictions. Although this action will stem or slow reserve losses, it will also slow economic growth and development somewhat.

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CONFIDENTIAL**DISCUSSION****Payments Trends During 1960-71**

1. One of the most striking features of Thai policy is the tenacity with which the authorities have followed cautious monetary and fiscal policies, including pursuing a favorable balance-of-payments position even when doing so was detrimental to growth. Maintaining stable exchange rates and a high level of reserves was regarded as critical because of the relatively important position foreign trade occupies in the economy. With large reserves, the Thai government was able to keep the economy generally free of restrictions on trade or other current transactions and to sustain an atmosphere of business confidence. Consequently, the open economy benefited from the stimulation of international competition and the corresponding increase in efficiency of private-sector business activities.

2. During the past decade, gross domestic product grew at an average annual rate of 9% - one of the best performances in the world. A boom in merchandise exports gave an important impetus to this growth in 1960-66, as world demand for rice surged upward and several new export crops (corn, kenaf, and tapioca) were developed. In 1967-70, merchandise export growth slowed to about 1% annually, but the impact on the balance of payments was masked for a few years because service receipts surged forward from large inflows of US dollars associated with Vietnam-related military spending. Because Thailand lacks a substantial capital goods industry, rapid increases in production were accompanied by growing import expenditures, but these were sustainable because exchange earnings had grown apace.

3. The growing reliance of the Thai economic boom on dollar earnings from US military expenditures, however, was bound to cause problems eventually. US expenditures in Thailand dropped after 1968, while merchandise exports continued their slow growth. Consequently, the balance of payments shifted from surplus to deficit, and foreign exchange reserves fell \$172 million during 1969-70, after rising about \$600 million in 1960-68. The drop in reserves in 1969-70 would have been greater if economic growth had been sustained at the earlier pace. Growth slowed to 6% a year, however, in response to restrictive monetary and fiscal policies.

4. The deterioration in the balance of payments moderated in 1971 as earnings from merchandise exports grew 16% because of increased international demand for a number of commodities, particularly rice. Rising concern over the growing trade imbalance and reserve losses had prompted the Thais to increase import duties in mid-1970, and this action was

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important in cutting import growth to less than 1% in 1971. Consequently, the overall payments deficit was reduced to \$16 million, compared with \$127 million the year before. Reserves, however, fell less than \$1 million because Thailand's Japanese yen (and some other foreign currency) holdings appreciated in the December 1971 monetary realignment.

5. Underlying this pattern of ups and downs was the Thai rice export performance and the comparatively slow effect of efforts to diversify exports (see Figure 1). Although other export categories increased rapidly, Thai trade fortunes were still most influenced by the world market for rice, which accounted for about one-fourth of total export earnings during the 1960s. Rice sales dropped from a peak 1.9 million metric tons in 1965 to 1.0 million tons annually during 1968-70, although earnings from rice did not drop until 1968 because of high world market prices. By 1971, however, rice prices had fallen 50% from the peak of early 1968 to less than \$100 per ton (see Figure 2). The market turned around toward the end of 1971 as a number of producers -- particularly the Philippines, South Korea, and Indonesia -- experienced production difficulties and resumed buying large quantities of rice in the world marketplace.

The Balance of Payments in 1972

6. The resurgence of merchandise export growth that began in the latter part of 1971 accelerated in 1972 (see Table 1) and was an important element in the \$200 million increase of exchange reserves to a total level close to \$970 million. Favorable world market developments contributed much to this performance, but other factors also were important. Thailand had a good agricultural harvest in 1971 and, because exports had been abnormally low in the prior few years, had accumulated record rice stocks that enabled it to meet the unexpected spurt in rice demand. Increased government activism in the export market also helped boost sales. Finally, US in-country military spending increased in response to the stepped-up pace of activities in Indochina, thereby causing invisibles receipts to rise unexpectedly.

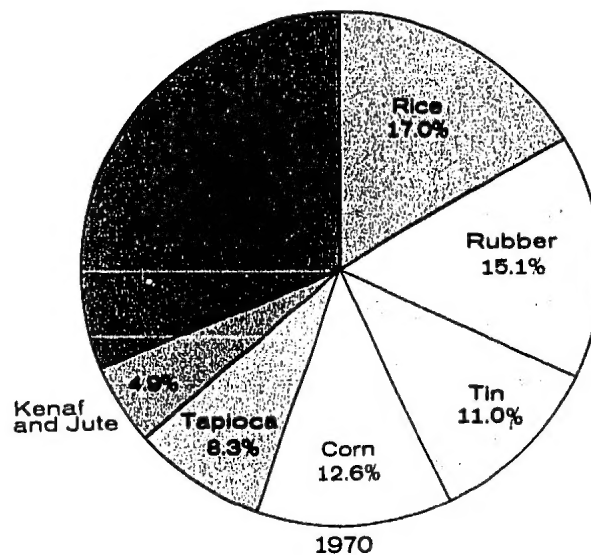
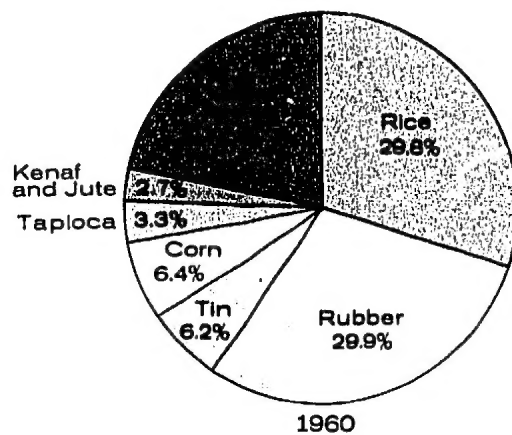
Merchandise Trade

7. An unprecedented gain in agricultural exports -- accompanied by a more modest increase in imports -- caused Thailand's perennial trade deficit to drop by nearly \$100 million in 1972 to only about \$400 million. Merchandise exports increased more than 30% to \$1 billion. Except for rubber earnings, which were affected by soft world prices, the gain in export

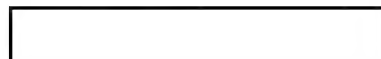
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Figure 1

Thailand: Composition of Merchandise Exports



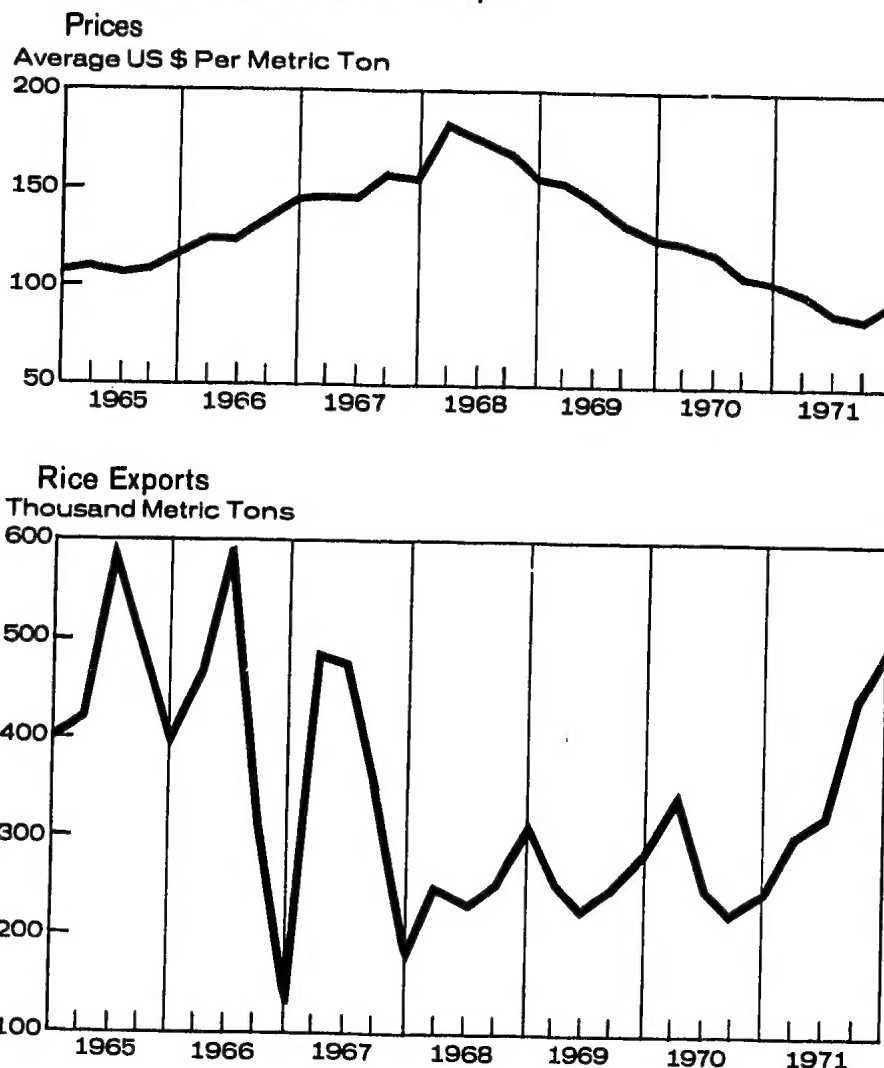
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Figure 2

Thailand: Prices and Rice Exports



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earnings was fairly evenly distributed throughout the commodity categories, although rice was the largest gainer, with sales volume up about 25% to a level of 2.0 million tons and earnings up nearly 45% to close to \$200 million. Most of the rice earnings increase was attributable to greater volume, but toward the end of the year, price increases also pushed earnings higher. Kenaf and jute sales also rose rapidly as raw-fiber producers in Bangladesh were forced, by the initiation of hostilities with Pakistan, to withdraw from

Table 1

Thailand: Summary Payments Position^a

	<i>Million US \$</i>		
	<i>1970</i>	<i>1971</i>	<i>1972^b</i>
Trade balance	-584	-483	-400
Merchandise exports	685	796	1,050
Rice	121	140	200
Kenaf and jute,			
corn, and sugar	128	170	250
Other commodities	436	486	600
Merchandise imports	1,270	1,279	1,450
Receipts from US			
military spending	214	198	220
Other: net service			
receipts	74	68	100
Official assistance	46	37	30
Net capital inflow	123	164	250
Overall balance	-127	-16	200

a. Because of rounding components may not add to the totals shown.

b. Estimated. All 1972 data - except year-end reserves - are preliminary estimates based on partial returns. For example, complete trade data are available for only the first six months of 1972. Aggregate balance-of-payments data are available through the third quarter. The data for 1972 are particularly sensitive to revisions because errors and omissions (consisting mostly of unidentified capital inflows) were particularly large - some \$50 million through the third quarter.

the world market, and buyers turned to Thailand as an alternative supplier. In the first half of 1972, for instance, kenaf and jute earnings were close to 50% above the comparable period of 1971. Corn sales were also strong in the first half of the year, but then slipped somewhat because of supply constraints caused by a poor summer harvest. Nevertheless, the strong sales effort in the first half, coupled with price increases beginning in the fall, was sufficient to raise earnings for corn about 10% over the 1971 earnings level. Sugar had a banner year as Bangkok - which had withdrawn from the International Sugar Agreement (ISA) in 1971 - sold 426,000 tons (much of it under long-term contract) to earn \$60 million, compared with \$16 million from 145,000 tons in 1971.

8. Favorable external developments accounted for the largest share of the improvement in trade, but Thai government measures were at least partly responsible. Some of these policies were implemented initially in

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1971, but their full impact was not felt until 1972. Most important were government efforts to bolster rice export volume, which had stagnated at about 1.0 million tons annually during 1968-70. Credit sales and government-to-government rice sales were initiated, and the rice premium (an export tax) was eliminated for most grades of Thai rice, although it was reimposed in the latter part of 1972. Bangkok also began to promote exports directly by approving the establishment of trade offices overseas and sending out annual trade missions to solicit new orders. As noted, a decision to withdraw from the ISA opened a new and substantial sugar market to Thai exporters. On the domestic side, tax credits and other incentives were extended to manufacturers producing goods primarily for export, and interest rates on letters of credit for exports were reduced.

9. Although imports increased in 1972, the growth was slower than that for exports. Through the first six months of the year, imports totaled nearly \$700 million, an 11% increase over the comparable period in 1971; and, for the full year, import growth is estimated at close to 13%. Preliminary evidence indicates that the 1971 yen revaluation was a primary factor in pushing up Thailand's import bill. Japan is Thailand's major trade partner, accounting for 35%-40% of total imports in recent years. Increases in the price of Japanese goods apparently had little negative effect on the volume of these imports. The dollar value of imports from Japan during the first half rose 11% over the comparable period of 1971, while the volume of shipments remained largely unchanged. The greatest growth in total imports occurred in the consumer goods categories, where the supply of Japanese goods is highest.

10. Consumer goods, including intermediate as well as finished items, were the fastest growing import category in 1972, registering a 21% rise in the first half of the year, compared with the same period of 1971. Greater spending by US military personnel based in-country and increased demands of the tourist industry were factors in this growth. Industrial production rose somewhat in 1972, but continuing excess capacity in the manufacturing and construction sectors apparently precluded much increase in investment goods imports, which rose only 8% in the first half.

Services

11. Net services receipts grew last year to about \$320 million from \$266 million in 1971. Most of the increase came from greater US military spending in Thailand and from tourism. In the spring, the United States augmented its Thailand-based air capability in response to the North Vietnamese offensive; US force levels, which had dropped to 32,000 in early 1972, rose sharply to 44,000 men. Earnings from US military spending and tourism alone totaled \$220 million during the first nine months of

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the year, compared with \$180 million for the same period of 1971. The increase in services, coupled with the reduced trade deficit, resulted in a reduction of the current account deficit to about \$80 million.

Capital Movements

12. A sharp rise in private foreign investment underlies the increase in net capital inflows to an estimated \$280 million in 1972. In the first three quarters of the year, net private investment increased two-thirds over the 1971 pace to \$110 million, and public investment and official assistance provided \$55 million, as shown in Table 2. A lack of private investment growth and (as noted earlier) continuing excess industrial capacity suggest that, although private foreign investment inflows increased to \$110 million, the funds were used to increase working capital and other liquid balances rather than building up the productive base. Most of the gain in direct private investment, for example, was attributed to foreign firms adding to their balances in Thai banks. A rise in portfolio and short-term capital inflows reportedly occurred in response to lower interest rates in Europe and increased demand for financing the record level of trade.

Table 2

Thailand: Capital Movements

	<i>Million US \$</i>	
	<i>January-September</i>	
	<i>1971</i>	<i>1972</i>
Total	163	217
Private capital	66	110
Direct investment	29	55
Other long-term	33	42
Short-term	4	13
Public capital	32	30
Official transfers	32	25
Errors and omissions	33	52

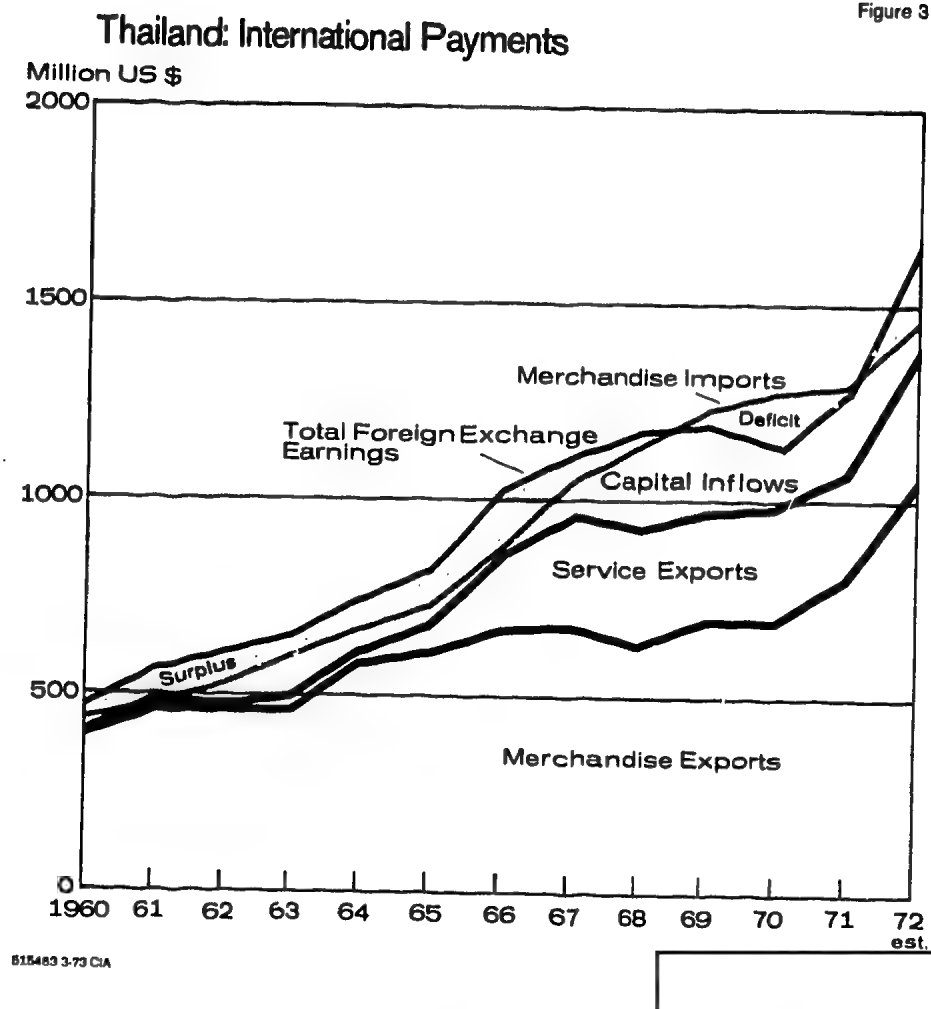
Foreign Exchange Reserves

13. Buoyed by the strong export performance and improvement in the other accounts, foreign exchange reserves rose \$200 million in 1972 (see Figure 3), with \$155 million of the gain occurring in the first six

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Figure 3



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months of the year. In December alone, more than \$50 million was added to reserve holdings, largely on the strength of record rice sales. The December increase was nearly double that accumulated during the last month of 1971 and compares with declines for the same month in the previous two years. Currently, reserves are the equivalent of eight months of imports at the 1972 rate; this is above the record low seven months' level recorded in 1970 but still well below the 1968 peak of 10 months of imports.

The Payments Outlook for 1973

14. Thailand's international payments position this year will be strongly influenced both by developments in the world rice market and

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by the declining US military presence in Southeast Asia. Agricultural output is down because of poor weather this past summer. Although world demand for rice and several other major crops is expected to remain high, Bangkok will be hard pressed to equal the level of merchandise exports reached in 1972. Other foreign exchange earnings should drop -- but only moderately -- because of planned reductions in the US presence. The import bill, on the other hand, is likely to continue expanding rapidly owing both to sustained growth of the Thai non-agricultural sector and to the higher import prices due to the devaluation of the dollar and the upward float of the Japanese yen. Reflecting these developments, foreign exchange reserves are projected to drop.

Merchandise Exports

15. Export performance will be disappointing this year because poor weather in the summer has constrained the amounts of rice and corn available for export. Particularly crucial is the size of the rice harvest currently under way. Unfavorable weather disrupted planting schedules, particularly in major dryland areas in the North and Northeast. Preliminary official estimates place the rice harvest at only 11.7 million tons of paddy, a drop of about 1.5 million tons from last year's harvest.

16. If the harvest is as poor as indicated, Thailand will be hard pressed to supply its traditional rice markets and will be unable to supply newer markets developed in the past few years. Past consumption patterns suggest that a paddy total of somewhat less than 12 million tons from the current harvest will permit 1 million tons or so of rice exports. With a second rice crop in late spring of about 400,000 tons and the availability of rice in November and December from the next major crop, Thailand is likely to export 1.0 million tons to 1.3 million tons of rice in 1973. Drawing down rice stocks to capitalize on high prevailing rice prices offers the possibility of slightly exceeding this range.¹ Because prices are expected to remain high throughout the year, Thailand probably will earn between \$140 million and \$200 million (compared with \$200 million in 1972).

17. The outlook for corn, kenaf and jute, and sugar exports, which account for about 25% of the total, is not as good. The drought affected the corn crop, which totaled only 1.3 million tons, compared with 2.3 million tons in 1971, and substantial drops in foreign exchange earnings from this commodity are thus forecast for 1973. Thailand had contracted to sell 1.4 million tons to Japan and Taiwan last fall, but has since had to renegotiate the contracts and will supply a total of only 780,000 tons

1. Some sale of stocks has already occurred. Rice exports during January, for instance, were 50% larger than in the preceding January; this sort of increase could only have come from stock drawdowns.

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to the two countries. An additional 280,000 tons is to be shipped to Hong Kong, Malaysia, and Singapore. At current prices, therefore, a decline of about 40% in corn earnings from 1972 to \$70 million is likely. Kenaf exports will also probably drop as world purchases continue to be redirected toward the traditional South Asian suppliers. In addition, Thailand will be hard pressed to maintain sugar earnings at the 1972 level because of domestic processing and grinding constraints.

18. Most other export items should rise moderately in 1973, but not to the degree witnessed last year. Rubber and tin earnings, for example, should rise slightly as world prices continue to firm. Tapioca exports should grow as quality standards are improved and tapioca gains greater acceptance among European buyers. Lesser agricultural export items -- tobacco, sorghum, kapok fibers, and the like -- should benefit from government promotional efforts in new markets as well as continued expansion in established markets and therefore are projected to rise 5% or more on average. Exports of manufactures -- now less than 10% of the total -- will probably add little to earnings. Even if a substantial share of orders for Indochina reconstruction is received by Thai businessmen, the value of goods that Thailand could supply (cement and other construction materials) would be small.²

19. In summing these rough indications of 1973 export levels (see Table 3), earnings could be off as much as \$100 million (10%) and will probably not be any better than last year under the most optimistic assumptions.

Other Sources of Foreign Exchange Earnings

20. Projection of other elements of Thailand's current account indicates little opportunity for expansion this year. Net receipts for services and other invisibles are expected to decline in 1973 on the order of \$20 million. This decline will come about as slow reductions in US military expenditures in Thailand³ are only partly offset by continued growth of earnings from tourism and investment income.

21. Official assistance and capital inflows are also projected to fall this year, about 10%, with half of the decline coming from lower economic aid levels. US assistance to Thailand in fiscal year (FY) 1974 will be roughly

2. Even under the most optimistic assumptions, for example, South Vietnam's cement requirement related to reconstruction probably would not increase more than \$10 million this year.

3. US force levels are currently being augmented somewhat because some air units and command responsibilities are being phased out of Vietnam and set up in Thailand. Over the course of the full year, however, a sustained low level of hostilities in Indochina would reduce the demand for US presence and the amounts of in-country expenditures.

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CONFIDENTIAL**Table 3****Thailand: Merchandise Exports**

	<i>Million US \$</i>	
	<i>1972</i>	<i>1973 Projections</i>
Total exports	1,050	950-1,050
Major commodities	685	565-635
Rice	200	140-200
Rubber and tin	165	170
Corn	115	70
Kenaf and jute	75	55
Sugar	60	50-60
Tapioca	70	80
Lesser commodities	365	385-415

one-half that funded in FY 1973. The promulgation of new foreign investment laws and incentives, lower interest rates, and other government measures should help sustain capital inflows close to 1972 levels. The Indochina settlement could stimulate investment throughout the region, with part of the gain accruing to Bangkok, but there is not likely to be an immediate rise over 1972 levels. Foreign investors probably will move cautiously until prospects for peace are more fully known. Moreover, they will continue to be concerned over new restrictions on foreign national employment decreed by the Thai government in late 1972, and will be somewhat discouraged by the fact that there is excess capacity in a number of industries.

Import Patterns and Financing

22. Imports probably will grow some 10%-15% in 1973. The floating of the Japanese yen and the 10% Thai currency devaluation -- undertaken in step with the change of the US price of gold -- undoubtedly will add significantly to import costs because the Thai demand for Japanese goods, as suggested by the 1971 yen revaluation, seems to be relatively insensitive to price increases. In the consumer goods categories, Japanese imports are often the only goods available in local markets. The Japanese also constitute the largest source of private investment and the largest foreign business contingent working in Thailand, and their influence is reflected in orders placed almost exclusively in Japan. In many instances, Japanese businessmen provide not only goods but also the managerial expertise and financing needed to merchandise goods successfully in Thailand.

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23. Intermediate and capital goods imports are also expected to rise faster than in 1972, as industry continues to recover from the recession of 1970 and development spending picks up. After two consecutive years of cuts in development spending, Bangkok has approved a modest expansion of public investment in the FY 1973 budget.

24. Import growth within the range of 10%-15% would probably lead to a foreign exchange reserve drawdown. With foreign exchange earnings running at some \$1,500 million to \$1,600 million in 1973 (see Table 4) and imports running at \$1,600 million to \$1,650 million, reserves could drop as much as \$150 million.

Table 4

Thailand: Exchange Earnings and Imports

	<i>Million US \$</i>	
	<i>1972</i>	<i>1973 Projections</i>
Total foreign exchange earnings	1,650	1,500-1,600
Merchandise exports	1,050	950-1,050
Net services and transfers	320	300
Capital movements and assistance (including errors and omissions)	280	250
Imports	1,450	1,600-1,650
Change in foreign exchange reserve holdings	200	-150 - 0

Impact on Economic Policies

25. Thus it appears that the balance of payments will deteriorate this year and foreign exchange reserves will erode somewhat. A reserve drawdown of up to \$150 million by itself would not be particularly unsettling to Bangkok, as the level of exchange holdings would still total more than \$800 million. Moreover, the reserve accumulation last year was greater than the anticipated 1973 drawdown.

26. The Thais, however, attach great importance to maintenance of their reserve position, and a large exchange loss is likely to elicit a strong policy reaction that could slow growth and development. Such a reaction will be especially likely if Thai expectations of another banner year do not materialize. Recent statements by Thai officials suggest they expect

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to maintain export earnings close to the 1972 level and are counting heavily on peace in Indochina and associated reconstruction orders to stimulate domestic production. By the same token, although they acknowledge rising demand for imports, they have not publicly addressed the question of rapid import growth and the possibility of reserve drawdowns.

27. Thai economic policy decisions also depend on longer term prospects, which are not especially favorable. As noted earlier, Thailand's export performance remains tied to a relatively limited group of agricultural products, demand for which is largely set by external factors. In the longer term, the outlook for these commodities is for modest growth at best; yet export promotion continues to be most heavily directed toward these products. Perhaps the upsurge in world demand for some of these products in the last two years diverted the Thais from concentrating on developing industrial exports. Export-oriented manufacturing based on locally provided raw materials has a large potential, particularly in such lines as seafood processing and fruit canning. Thailand also has an abundant supply of relatively well-trained low-cost labor to process imported raw materials for export, as Korea and Taiwan have been doing. Government activity to encourage industrial exports has been increasing, but results are few. Development of the country's only industrial estate, for example, has been slow, and the government has yet to establish any manufacturing facilities outside the customs barriers. Even if government policies shifted more toward developing these kinds of exports, the impact on export earnings would not be felt for a few years.

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29. Faced with these trends in exports and assistance, the Thais are unlikely to allow their reserves to fall very far before restricting imports. Although this could be accomplished in a number of ways (such as increasing import taxes, rationing imports, or restricting private spending by means of credit controls), they probably would prefer to increase tariffs on consumer goods selectively as they did in mid-1970 or perhaps impose quantitative limits on Japanese imports. The latter action would reduce Thai dependence on Japanese suppliers, a change the leadership would certainly look on favorably. Regardless of the method used, however, a substantial cut in imports would soon hit producers' goods and probably would not be achieved without slowing the rate of economic growth.

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